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Department of the Treasury
Internal Revenue Service

Instructions for Schedule PH (Form 1120)

U.S. Personal Holding Company Tax

(Section references are to the Internal Revenue Code unless otherwise noted.)

General Instructions

Purpose of Schedule

This schedule is used to figure personal holding company tax.

Who Must File

Every personal holding company must attach this schedule to its income tax return.

Definitions

Personal Holding Company.—A corporation is a personal holding company (PHC) if:

- At least 60% of its adjusted ordinary gross income for the tax year is PHC income; **and**
- At any time during the last half of the tax year more than 50% in value of its outstanding stock is owned, directly or indirectly, by not more than 5 individuals. See section 543(a) for the definition of PHC income and section 543(b)(2) for the definition of adjusted ordinary gross income.

However, the following corporations are excepted from the term "personal holding company": tax-exempt corporations; banks; domestic building and loan associations; life insurance companies; surety companies; foreign personal holding companies (as defined in section 552); certain lending or finance companies; foreign corporations (all of the stock of which during the last half of the tax year is owned by nonresident alien individuals) that do not have income under section 543(a)(7); certain small business investment companies operating under the Small Business Investment Act of 1958; corporations under the jurisdiction of the court in a Title 11 or similar case; and passive foreign investment companies. See section 542(c) for details.

At-risk and passive activities.—A corporation that has an activity subject to the at-risk or passive activity rules (or both), may have deductions and losses suspended under those provisions. Deductions and losses used in any of the computations for PHC tax should not include suspended at-risk and passive activity deductions and losses. Any prior year deductions and losses allowed under the at-risk and passive activity rules are treated as current year deductions and losses in the year they are allowed.

Individual.—An organization described in section 401(a), 501(c)(17), or 509(a), or a part of a trust permanently set aside or to be used exclusively for the purpose described in section 642(c) is also considered an individual. See section 542(a)(2).

Foreign Corporations Must File a Return.—If a foreign corporation that is a PHC does not file Schedule PH as required, the corporation will be charged a penalty. The penalty is 10% of the corporation's Federal income taxes (including the PHC tax) and is in addition to any other penalties charged the corporation. See section 6683.

Worksheet For Figuring Ordinary Gross Income, Adjusted Ordinary Gross Income, and the 60% PHC Income Test

1. Gross income. Nonlife insurance companies see section 543(c). See instructions	1	
2. Less: Gains from the sale or disposition of capital assets and section 1231(b) property	2	( )
3. Ordinary gross income—Combine lines 1 and 2. (Foreign corporations see instructions.)	3	
4. Adjustments: See instructions.		
(a) Adjustments described in section 543(b)(2)(A)	(a)	
(b) Adjustments described in section 543(b)(2)(B)	(b)	
(c) Interest income excluded under section 543(b)(2)(C)	(c)	
(d) Adjustments described in section 543(b)(2)(D)	(d)	
(e) Total adjustments—Add lines 4a through 4d	4(e)	
5. Adjusted ordinary gross income—Subtract line 4e from line 3	5	
6. Complete lines 15 through 26 in Part II, Schedule PH (Form 1120). Divide the amount on line 26, Part II, by the amount on line 5 above. Express the result as a percentage	6	%

If line 6 is **less than 60%,** the corporation is not a PHC. Do not file Schedule PH (Form 1120). If line 6 is **60% or more *and*** the stock ownership requirements (described above) are met, the corporation is a PHC and must complete line 27, Part III and file Schedule PH (Form 1120) with its income tax return.

Worksheet Instructions

Lines 1 through 3.—Ordinary gross income is gross income as defined in section 61 and the related regulations, computed without gains from the sale or disposition of capital assets and without gains from the sale or other disposition of property described in section 1231(b). Foreign corporations (if not exempt under section 542(c)(7)) should only include gross income subject to U.S. tax.

Line 3.—If all of a foreign corporation's stock is owned during the last half of the tax year by nonresident alien individuals (directly or indirectly), ordinary gross income is reduced by all items of income which would otherwise constitute PHC income, except for amounts received under personal service contracts and from their sale (Part II, line 24).

Line 4a.—Enter the total of the following deductions allocable to gross income from rents (not to exceed the gross income from rents): depreciation and amortization of property other than tangible personal property not customarily retained by any one lessee for more than 3 years; property taxes; interest; and rent. See section 543(b)(3) for the definition of the term "rents."

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Line 4b.—Enter the total of the following deductions allocable to gross income from mineral, oil, and gas royalties (including production payments and overriding royalties) and gross income from working interests in an oil or gas well: depreciation; amortization; depletion; property and severance taxes; interest; and rent. The total deductions allocable to royalties may not exceed the gross income from the royalties, and the total deductions allocable to working interests may not exceed the gross income from the working interests.

Line 4c.—Include the following interest on this line: **(1)** interest received on a direct obligation of the U.S. held for sale to customers in the ordinary course of trade or business by a regular dealer who is making a primary market in the obligations; and **(2)** interest on a condemnation award, a judgment, or a tax refund.

Line 4d.—Enter the total of the following deductions allocable to gross income from compensation for the use of, or the right to use, any tangible personal property manufactured or produced by the corporation, if during the tax year the corporation is engaged in substantial manufacturing or production of tangible personal property of the same type: depreciation and amortization of property other than tangible personal property that is not customarily retained by any one lessee for more than 3 years; property taxes; interest; and rent. The total deductions allocable to the compensation may not exceed the gross income from the compensation.

Specific Instructions

Part I

Additions

Line 1—Taxable income before net operating loss deduction and special deductions.—Enter the amount shown on line 28, Form 1120, page 1. If the income on line 28 was figured using section 443(b) (placing the income on an annual basis), refigure it without that section.

A foreign corporation must figure line 1 by including only income derived from U.S. sources or effectively connected with a U.S. trade or business, reduced by deductions allowable in determining taxable income before the net operating loss deduction and special deductions.

If all of a foreign corporation's stock is owned during the last half of the tax year by nonresident alien individuals (directly or indirectly), taxable income for section 545(a) is only income received under a contract for personal services as described in section 543(a)(7), reduced by deductions attributable to that income, and adjusted as provided in section 545(b) with respect to that income.

Line 2—Contributions.—See the Instructions for Forms 1120 and 1120-A.

Line 3—Expenses and depreciation.—If the corporation earned rent or other compensation for the use of, or right to use, property that was less than the total allowable expenses and depreciation, complete Schedule A and enter the excess on line 3.

This adjustment must be made unless it can be established, as provided in section 545(b)(6), that the rent or other compensation the corporation received was the highest obtainable. If none was received, show that none was obtainable. The property must be held in the course of a business carried on for profit. There must be a reasonable expectation that the property's operation would result in a profit, or that the property was necessary to conduct the business.

If excess deductions are claimed, do not complete Schedule A. Instead, attach a statement reporting the deductions with the complete facts, circumstances, and arguments to support them. The statement must include the information required by Regulations section 1.545-2(h)(2).

Deductions

Line 5—Federal and foreign income, war profits, and excess profits taxes.— Attach a schedule showing the kind of tax, the tax year, and the amount. Under section 545(b)(1), the corporation can deduct Federal income taxes accrued during the tax year, but not the accumulated earnings tax under section 531 or the personal holding company tax under section 541.

The foreign tax credit is not allowed against PHC tax. A deduction is allowed, however, for income, war profits, and excess profits taxes accrued (or considered paid under section 902(a) or 960(a)(1)) during the tax year to foreign countries and U.S. possessions. This is true if a credit for the taxes was claimed when figuring the corporation's income tax.

Line 6—Contributions.—Compute the deduction using the limitations under section 170(b)(1)(A), (B), and (D) but without section 170(b)(2) and (d)(1). When computing the limitations under section 170(b)(1), use taxable income computed with the adjustments (other than the 10% limitation) provided in section 170(b)(2) and (d)(1) and without any expenses and depreciation disallowed under section 545(b)(6).

Line 7—Net operating loss.—Section 545(b)(4) provides that instead of the net operating loss deduction provided in section 172, a deduction is allowed for the net operating loss (as defined in section 172(c)) for the preceding tax year figured without the deductions provided in Part VIII (except section 248) of subchapter B.

Line 8—Net capital gain.—Net capital gain for a foreign corporation is determined by taking into account only gains and losses that are effectively connected with the conduct of a trade or business within the U.S. that are not exempt from tax under treaty.

Line 9—Amounts used or irrevocably set aside.—Subject to the limitations in section 545(c), section 545(c)(1) allows a deduction for amounts used, or irrevocably set aside, to the extent reasonable, to pay or retire qualified indebtedness as defined in section 545(c)(3). This rule will apply if for at least one of the two most recent tax years ending before February 26, 1964, the corporation was not a PHC but would have been a PHC if the rules under section 542 that applied to the first tax year beginning after December 31, 1963, had been in effect for that tax year; **or**

the amounts used or irrevocably set aside to pay or retire qualified indebtedness were obtained by reason of section 381(c)(15).

A corporation claiming a deduction under section 545(c)(1) must provide detailed information and if necessary, a computation that shows that the corporation is a corporation described in section 545(c)(2)(A). If the corporation is claiming the deduction by reason of section 381(c)(15), the corporation must provide detailed information showing that the distributor or transferor corporation was a corporation described in section 545(c)(2)(A).

A corporation succeeding to the deduction must adjust its qualified indebtedness to take this indebtedness into account.

The corporation must establish that the amount reported as a deduction is reasonable. Attach a statement giving a description of the indebtedness, date incurred or assumed, date due, and plan for payment or retirement of the obligations (indicating date and method of adoption). If the plan is covered by a mandatory sinking fund agreement or similar arrangement, include a copy of the indenture or agreement by which the fund was established and under which it is maintained.

The statement must also include:

- The amount of indebtedness on January 1, 1964; **and**
- The total amounts used or irrevocably set aside to pay or retire the indebtedness in earlier tax years beginning on and after January 1, 1964; **and**
- The amount actually used during the tax year to pay or retire the indebtedness; **and**
- The amount irrevocably set aside during the tax year to pay or retire the indebtedness but not actually used during the tax year for that purpose.

The statement must also indicate if the deduction claimed represents:

- An amount actually used during the tax year to pay or retire the indebtedness; **or**
- An amount irrevocably set aside during the tax year to pay or retire the indebtedness; **or**
- A combination of the two.

If the amount reported as a deduction on line 9 represents an amount irrevocably set aside, and not used to pay or retire the indebtedness, attach a statement explaining the circumstances and method by which it was irrevocably set aside.

The corporation must also provide a schedule for amounts described in section 545(c)(5) that reduce the amounts used or irrevocably set aside to pay or retire qualified indebtedness.

Section 545(c)(4) allows corporations to elect to treat as nondeductible certain amounts used or irrevocably set aside to pay or retire qualified indebtedness that are otherwise deductible under section 545(c)(1). See Regulations section 1.545-3(e) for time and manner of making the election.

Line 13—Dividends paid after the end of the tax year.—The corporation may elect to treat dividends (other than deficiency dividends) paid after the end of the year and before the 16th day of the third month following the end of the tax year, as paid during the tax year. Enter these dividends on line 13 but not in Schedule B.

Line 14—Undistributed personal holding company income of certain foreign corporations.—If 10% or less in value of the outstanding stock of a foreign corporation is owned (see section 958(a)) during the last half of the tax year by U.S. persons, undistributed PHC income is determined by multiplying the undistributed PHC income (determined without this instruction) by the percentage in value of the corporation's outstanding stock. This percentage is figured by using the greatest percentage in value of its outstanding stock owned by the U.S. persons on any one day during the period.

Part II

Personal Holding Company Income

Note: *Use the worksheet on page 1 to figure ordinary gross income and adjusted ordinary gross income.*

Line 16b—Amounts excluded under section 543(a)(1)(A), 543(a)(1)(B), 543(a)(1)(D), or 543(b)(2)(C).—Include the following interest on this line:

(1) interest constituting rent,
(2) interest on amounts set aside in a reserve fund under section 511 or 607 of the Merchant Marine Act of 1936,
(3) interest received by a broker or dealer (within the meaning of section 3(a)(4) or (5) of the Securities Exchange Act of 1934) in connection with: **(a)** any securities or money market instruments held as property described in section 1221(1), **(b)** margin accounts, or **(c)** any financing for a customer secured by securities or money market instruments, and **(4)** interest included on line 4(c) of the worksheet.

Lines 19a through 19c—Adjusted income from rents.—If both of the following tests are met, rents are not considered PHC income and these lines should not be completed:

(1) The amount computed for line 19c is at least 50% of adjusted ordinary gross income (line 5 of the worksheet); and

(2) The sum of line 3, Schedule B; and line 13, Part I is at least equal to the amount, if any, that PHC income (computed without regard to lines 19c and 23 and by including as PHC income, copyright royalties and the adjusted income from mineral, oil, and gas royalties) exceeds 10% of ordinary gross income (line 3 of the worksheet).

If either of the above tests are not met, enter rents (as defined in section 543(b)(3)) on line 19a. Enter the amount from line 4(a) of the worksheet on line 19b and complete line 19c.

Lines 20a through 20c—Adjusted income from mineral, oil, and gas royalties.—If all of the following tests are met, mineral, oil, and gas royalties are not PHC income and these lines are not completed:

(1) The amount computed on line 20c is at least 50% of adjusted ordinary gross income (line 5 of the worksheet); and

(2) PHC income (computed without regard to line 20c, and by including as PHC income, copyright royalties and the adjusted income from rents) is not more than 10% of ordinary gross income (line 3 of the worksheet); and

(3) The deductions allowable under section 162 (other than compensation for personal services rendered by a shareholder and deductions specifically allowable under other sections), are 15% or more of adjusted ordinary gross income.

If any of the above tests are not met, enter mineral, oil, and gas royalties (including production payments and overriding royalties) on line 20a. Enter the amount included on line 4(b) of the worksheet on line 20b and complete line 20c.

Line 21—Copyright royalties. **(Note:** *For royalties received in connection with the licensing of computer software, see below.***)**—If all 3 of the following tests are met, copyright royalties are not PHC income and should not be included on line 21:

(1) The amount computed for line 21 (exclusive of royalties received for the use of, or right to use, copyrights or interests in copyrights on works created in whole or in part by any shareholder) is at least 50% of ordinary gross income (line 3 of the worksheet);

(2) PHC income computed: **(a)** without regard to copyright royalties (other than royalties received for the use of, or right to use, copyrights or interests in copyrights on works created in whole or in part by any shareholder owning more than 10% of the corporation's stock), **(b)** without regard to dividends from any corporation in which the taxpayer owns at least 50% of all stock (by vote and value) and which corporation meets test **(1)** above and **(3)** below, and **(c)** by including as PHC income the adjusted income from rents and the adjusted income from mineral, oil, and gas royalties, is not more than 10% of ordinary gross income (line 3 of the worksheet); **and**

(3) The sum of the deductions allocable to the royalties allowable under section 162 (other than deductions for compensation for personal services rendered by shareholders, deductions for royalties paid or accrued, and deductions specifically allowable under sections other than section 162) is at least 25% of the amount by which ordinary gross income (line 3 of the worksheet) exceeds the sum of the royalties paid or accrued and the depreciation allowable with respect to copyright royalties.

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Royalties received in connection with the licensing of computer software.—Royalties received in connection with the licensing of computer software are not considered PHC income if the following 4 tests are met:

(1) The corporation is engaged in the active business of developing, manufacturing, or producing computer software;

(2) Such royalties are at least 50% of ordinary gross income (line 3 of the worksheet);

(3) The sum of the deductions allowable under sections 162, 174, and 195 that are allocable to the computer software business is at least 25% of ordinary gross income (or the average of the deductions for the 5 tax years ending with the current tax year is at least 25% of the average ordinary gross income for that period); **and**

(4) The sum of line 3, Schedule B; and line 13 is at least equal to the amount, if any, by which PHC income (as modified in accordance with section 543(d)(5)(B)) exceeds 10% of ordinary gross income.

See section 543(d) for more information.

Line 22—Produced film rents.—Produced film rents are not considered PHC income if the rents constitute at least 50% of ordinary gross income (line 3 of the worksheet). See section 543(a)(5) for the definition of "produced film rents."

Line 23—Compensation received for use of corporation property by 25% shareholder.—This line applies only to a corporation with other PHC income in excess of 10% of ordinary gross income (line 3 of the worksheet). For purposes of this limitation, other PHC income is modified in accordance with section 543(a)(6)(C). Enter on line 23, amounts received as compensation for the use of or right to use tangible property of the corporation by or for an individual who at any time during the tax year owned, directly or indirectly, at least 25% in value of the corporation's outstanding stock.

Line 24—Amounts received under personal service contracts and from their sale.—Enter amounts received under a contract under which the corporation is to furnish personal services if some person other than the corporation has the right to designate the individual who is to perform the services (or if the individual who is to perform the services is designated in the contract). Also include amounts received from the sale or other disposition of such a contract. This line applies only if the individual who has performed, is to perform, or may be designated to perform such services, owned at some time during the tax year 25% or more in value of the corporation's outstanding stock.

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